No. 11587

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

---

L. H. and FLORENCE L. MCCLINTOCK, dba MCCLINTOCK DISPLAY CO., a copartnership,

*Appellants,*

*vs.*

HARRY C. WESTOVER, Collector of Internal Revenue,

*Appellee.*

---

## BRIEF FOR THE APPELLANTS.

---



JOHN T. RILEY and
RICHARD K. YEAMANS,
770 Subway Terminal Building, Los Angeles 13.
*Attorneys for Appellants.*

Parker & Company, Law Printers, Los Angeles. Phone TR. 5206.

## TOPICAL INDEX

# INDEX TO APPENDIX.

# TABLE OF AUTHORITIES CITED

## Cases



## Miscellaneous



## Statutes

TEXTBOOKS

No. 11587

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

---

L. H. and Florence L. McClintock, dba McClintock Display Co., a copartnership,

*Appellants,*

*vs.*

Harry C. Westover, Collector of Internal Revenue,

*Appellee.*

---

## BRIEF FOR THE APPELLANTS.

---

### Opinion Below.

The opinion of the District Court [R. 20-22] is a memorandum opinion.

### Jurisdiction.

This is an appeal from a judgment of the District Court entered October 16, 1946 [R. 32], in favor of the defendant, and denying the plaintiff's prayer for recovery of $20,673.38 [R. 6], paid and alleged to have been illegally assessed as manufacturers sales taxes. Motion for new trial was made [R. 32-36] and denied by order dated December 24, 1946 [R. 36]. Notice of appeal was filed February 18, 1947 [R. 37]. The jurisdiction of this Court is invoked under Section 128(a) of the Judicial Code, as amended.

## Questions Presented.

First: Whether the District Court erred when it construed the so-called "Rental Agreement" [R. 57, 70, 73, 77, 82] as a lease in legal contemplation.

Second: Whether the District Court erred when it construed the so-called "Rental Agreement" [R. 57, 70, 73, 77, 82] as a lease of the type which Congress contemplated when it inserted the word "lease" in Section 3440 of the Internal Revenue Code.

Third: Whether the District Court erred when it failed to construe Section 3441(b), Internal Revenue Code, as prescribing the manner in which the tax should be computed in the case of taxable sales, other than taxable sales at wholesale, and whether the District Court further erred when it failed to construe Section 3441(c), Internal Revenue Code, as prescribing the time of payment of the tax, in the limited instances therein enumerated.

Fourth: Whether the District Court erred when it determined that appellants did not use their product in the operation of a business in which they were engaged within the meaning of Section 3444 of the Internal Revenue Code.

## Statutes and Regulations Involved.

The applicable statutes and regulations will be found in the Appendix, *infra*.

## Statement.

The case was tried by the Court sitting without a jury, and the evidence consisted of the testimony of two witnesses for the appellants, together with real and documentary evidence adduced by them. No evidence was introduced by the appellee. Appellants' testimony was, by stipulation [R. 54-55, 76], based on an assumed set of facts related to appellants' actual method of conducting their operations. After briefs were submitted, the Court rendered a memorandum opinion [R. 20-22], and subsequently filed findings of fact and conclusions of law favorable to the appellee [R. 23-30].

The following is a summary of the manner in which appellants conducted their rubber leaf decorative display service business:

Prior to the time appellants developed their decorative leaf service it was necessary and customary for meat markets to use parsley or some other natural green in decorating their meat counters. The use of these natural greens required the butcher or market operator to change them frequently because of natural deterioration. In addition, they were not washable, and if they became soiled or contaminated, it was either necessary to change the entire display or to allow the condition to remain, thereby producing an unsanitary situation. The time required of the butcher to make a change in his decorations was considerable and the expense of procuring fresh greens was often very substantial. Further, in many parts of the country at various times of the year, no fresh greens were available for decoration.

Appellants, after considerable experimentation, developed a decoration made of rubber, colored green, and cut to resemble parsley. They also developed a metal clip for

display use in holding the decoration. This decoration, and the clip, provided the color contrast and decorative effect which was desired in meat markets. However, appellants soon discovered that many butchers were not interested in purchasing this unique invention. It seemed that these butchers were unable themselves economically to install the necessary holders in the counters and when the decoration became soiled, they lacked facilites for renovation: but most important of all, many butchers preferred that a display expert solve their display problems and service their display needs. It was to meet this situation that appellants expanded their business to include not only manufacturing and sale of the decoration, but also a display service which appealed to the majority of meat markets.

Specifically, appellants' representative is a meat display expert [R. 62, 63]. He prepares an accurate diagram of the counter or showcase involved, [R. 46], determines the angle of the glass at the front of the counter [R. 47], and from this information and from the nature of the meat products sold ascertains what and how many decorations are needed [R. 46]. He removes the platters of meat from the display case [R. 47]. He washes and cleans the case [R. 47]. He installs holders and arranges the leaf in the holders [R. 47]. He then replaces and arranges the meat in an attractive manner on the platters [R. 48] and will even suggest re-cutting of the meat to obtain a more effective display [R. 48]. When the platters have been replaced in the case, he completes the decoration by inserting rubber leaf units between the various platters [R. 48].

Appellants' representative returned regularly (during the period under consideration every sixty (60) days) and

redecorated the showcases [R. 60, 74]. He then would remove the rubber decorations which he believed were soiled and would replace them with new or renovated decorations, as he might elect [R. 61, 74].

In addition, if the occasion arose, the appellants' representative would upon request return to the market and redecorate at intervals other than the periodic service time [R. 61]. For example, if ammonia is spilled on the rubber leaf the leaf will turn black [R. 71]. This might occur at any time and appellants are prepared to redecorate and to render this and other special services [R. 61].

It has been the experience of appellants that at the time the sixty (60) day periodic service is rendered, their representative usually determines to replace in excess of 50% of all the decorations as well as a considerable percentage of the holders [R. 74].

All of this service saves the time of the butcher who would otherwise be required to procure and change the greens if he continued to use the old-fashioned parsley method [R. 63].

Appellants make only a periodic service charge in connection with their display service business [R. 61]. No additional charge is made for the original installation of the holders, no additional charge is made for special replacement of soiled decorative units [R. 72]; no additional charge is made for periodic replacements [R. 75]; and the charge has no relation to the number of units which are actually replaced when the display is serviced. That is, the charge remains the same whether 10% or 100% of the decoration is replaced at any time. Determination of the

number of rubber leaf units to be replaced rests almost entirely with appellants' representative [R. 81].

Appellants incur substantial expense in renovating the soiled decorations [R. 107-108], and devote a considerable portion of their plant to the operation. For example, the cost of transporting soiled decorations back to the plant and of transporting renovated decorations from the plant to the salesman, during the period under consideration, amounted to $13,568.16 [R. 108]. It was also necessary during that period of time to expend $29,580.80 in costs within the plant in renovating the decorations [R. 108]. It will be noted that this cost is something slightly in excess of 3¢ per unit renovated [R. 107]. Since each unit must be renovated approximately 4 times a year [R. 99], and since the cost of manufacturing a unit is approximately 20¢ [R. 106], it is apparent that the expense of renovating the unit during each year amounts to approximately 60% of its initial cost. Also indicative of the expenses to which appellants are put in connection with the service phase of their business, is the fact that they were required to maintain special machinery for renovation [R. 85] and that the renovating process itself consisted of a substantial number of steps which required approximately one week to complete [R. 79-80].

These expenses were included in and were recouped only by means of appellants' periodic service charge. The amount of that charge bears no direct relation to the sales price of the article. The average selling price of appellants' products was approximately 38¢ per 18-inch unit

[R. 52] whereas the periodic charge based on a similar unit, in cases of independent stores, was 7¢ per month [R. 101], from which it is apparent that a sum equal to the sales price would be recovered in only six months, by means of the service charge. It follows that the service charge included a great many expenses which appellants would not have been required to bear had they only sold their product.

Examination of the so-called "Rental Agreement" [R. 57, 70, 73, 77, 82], will show that it is a service ticket printed on a standard form by Western Sales Book Company. In addition, the uses to which it was put further illustrate that it is designed only, and primarily used, for accounting purposes [R. 98], and shows that it was purely incidental that it contained an acknowledgment that the rubber leaf decoration remained the property of the appellants. Some of the uses to which that slip is put are as follows: It serves as a receipt by appellants' representative that he has collected and received money [R. 68]; it shows the quantity of the rubber leaf decoration and holders installed by the salesman from which the accounting records are set up in appellants' Home Office [R. 95, 97, 98]; it is an acknowledgment by the market operator that the rubber leaf and holders described have been installed in his counters [R. 68]; and it further serves as an acknowledgment by such operator that appellants' representative has rendered the service to which he is entitled. It is used to inform the accounting department when an account is opened [R. 57, 58], when additional rubber leaf or holders are "added to" those already in the hands

of a customer, [R. 58-59, 70] or when a portion of the amount in the hands of the customer is "picked up" [R. 59], when an account is cancelled, and how much has been collected [R. 91]. In addition, appellants received from 24,000 to 30,000 of these completed sales tickets in the course of a year [R. 100] and many of these sales tickets were used to inform the accounting department that only service had been rendered [R. 73, 77].

The butcher, in short, contracted for a decorative display service for his showcases [R. 62-63] and had no right to possession of any particular decoration for any particular period of time. Appellants' obligation was to decorate the butchers' counters and maintain them in an attractive state [R. 62]. They were under no obligation to furnish a decoration of any particular kind. It was rubber but it might as easily have been something else. Appellants determined when the display was to be changed and determined exactly which articles of decoration and which holders were to be changed and replaced [R. 74, 81]. In brief, appellants were engaged in the business of deocrating meat showcases, and as a part of that business, furnished rubber leaf decorations manufactured by them [R. 62-63].

Appellants concede that they manufactured a taxable rubber article within the scope of Section 3406(a)(7), Internal Revenue Code, as it existed during the period from October 1, 1941, to October 31, 1942. The dispute exists as to the manner in which the amount of the manufacturer's excise tax should be computed.

## Summary of Argument.

The so-called "Rental Agreement" fails to identify any specific property as its subject, nor does it state any term, and, accordingly, it fails to meet the tests usually applied to determine whether an instrument is a lease.

Congress, when it used the language that "the lease of an article * * * shall be considered a taxable sale of such article" was contemplating only those leases which closely approximated sales, *i. e.,* leases wherein title passed to the lessee on completion of the payments called for, and the so-called "Rental Agreement" is very definitely not of that category.

At all events, Congress clearly has evidenced its intention that in the case of sales at wholesale the manufacturer's excise tax shall be computed on the price received; in the case of sales at retail the manufacturer's excise tax shall be computed on the fair wholesale market price of the articles (irrespective of the price for which in fact sold). It is further provided in all cases, that the whole of the tax shall be due and payable on the first of the month succeeding the month in which the taxable transaction occurred, except that in the cases of a lease, an installment sale, a conditional sale or a chattel mortgage arrangement—that is in the cases of the deferred payments specified—special provision is made to determine when the tax becomes due, *i. e.,* as the installments are actually collected, although, at the outset, the tax is computed in the same manner as in the case of other sales and it is merely to be paid over a period of time.

Appellants "used" the new rubber leaf decorations manufactured by them during the period from October 1, 1941 to October 31, 1942 "in the operation of a business in which they were engaged" and, accordingly, were subject to the excise tax computed on the fair wholesale market price of the decorations so used.

## ARGUMENT.

### I.

### The District Court Erred When It Construed the So-called "Rental Agreement" as a Lease in Legal Contemplation.

The Supreme Court of the United States in *Herryford v. Davis,* 102 U. S. 235, 244, 26 L. Ed. 160, 162 (1880), when considering a case which involved determination of whether a document was a lease or a conditional sales contract laid down the following guiding principle:

> "* * * It is not to be found in any name which the parties may have given the instrument, and not alone in any particular provision which it contains, disconnected from all the others, but in the ruling intention of the parites, gathered from all the language they have used. It is the legal effect of the whole which is to be sought for. *The form of the instrument is of little account.*" (Italics supplied.)

Applying this rule to the so-called "Rental Agreement" [R. 57, 70, 73, 77, 82], printed in quantity by Western Salesbook Company, and recognizing that "the form of the instrument is of little account", it is apparent that this printed accounting slip did not constitute a lease form. It does not by any manner of means purport to contain the entire understanding of the parties. There is nothing in it which can be said to describe any property which is leased to the X Super Market for any particular period of time. In fact, appellants could install the decorative service, return five minutes later and exchange half of it, return still a few minutes later and replace each 18-inch unit with two 9-inch units and the butcher would have no ground for complaint so long as his meat counters were properly decorated. There is nothing in the form which

required appellants to furnish an article made from rubber. It might have been changed from rubber to any other substance and no provision of the so-called "Rental Agreement" would have been violated. While appellants, except when rendering special service, as a matter of election on their part, made their periodic service every 60 days, they could as easily have elected to remove and replace the decoration every week, or every two weeks or they could have rendered this service every 90 days, had they so desired. All these things and more could come to pass without in any way being subject to any language whatsoever appearing on the standard printed form referred to and, in fact, without violating any understanding between appellants and the butchers they served.

It was said in *Levin v. Saroff,* 54 Cal. App. 285, 201 Pac. 961, 963:

> "To create a valid lease, but few points of mutual agreement are necessary: First, there must be a definite agreement as to the extent and boundary of the property leased; second, a definite and agreed term; and, third, a definite and agreed price of rental, and the time and manner of payment."

Accordingly, it is submitted that the sales slip designated "Rental Agreement" fails to measure up to the requirements of a lease in that it has no language from which the term thereof could be determined and, further, there is no specific property or even a specific type of property which is the subject of the lease. This conclusion is also borne out by the very volume in which these tickets were used, that is 24,000 to 30,000 per year [R. 100] which further negatives any idea that appellants entered into that many separate and distinct leases a year.

## II.

## The District Court Erred When It Construed the So-called "Rental Agreement" as a Lease of the Type Which Congress Contemplated When It Inserted the Word "Lease" in Section 3440 of the Internal Revenue Code.

The Congressional Committee Reports, both at the time the words "or leased" were inserted in the 1924 Revenue Act and at the time that language was inserted in the 1932 Act, as hereafter shown, as well as the general rules of statutory construction, compel the conclusion that Congress intended the tax to apply only to those leases which were in fact sales or which closely approximated sales.

Regulations 46, Section 316.9 [Appendix, *infra*], effective during the period under consideration, define a "lease" as:

> "* * * a continuous right to the possession or use of a particular article for a period of time. * * * The contract must give the lessee the right to possess or use the article, without interruption, for a period of time."

The record in this case is clear that appellants' representative determined which decorations and which holders would make the most attractive display. The butcher had no right to demand any particular decoration or to demand a new one instead of a renovated one, or even to demand one made of rubber. He had, in fact, no right to the possession of a "particular article," nor did he have a right to the possession of an article "without interruption, for a period of time." Appellants' representatives could and did remove soiled decorations from time to time and at various times. They might elect to change any part of the display. Ap-

pellants could at any time remove any particular decoration, their only obligation being to maintain an attractive display. It follows, at all events, that the Commissioner's Regulations themselves, by their very language, preclude a holding that appellants "leased" their product.

Research discloses that the assessment of a manufacturer's excise or sales tax on articles sold or leased first occurred in Section 900 of the Revenue Act of 1918. The words "or leased" were added at that time, but in neither the House, Senate nor Conference reports is reference made to the reason for including these words. Section 905 of the same act simply refers to "jewelry sold by a dealer." The latter section was amended by Section 604 of the Revenue Act of 1924, to provide that the tax was to be levied on "jewelry sold or leased." Concerning the addition of the words "or leased" inserted in Section 604, Senate Report 398, 68th Congress, 1st Session, found in 1939-1 C. B. (Part 2), page 294, contains the following very illuminating comment:

> "Since dealers frequently dispose of goods under a form of contract termed a 'lease', *which in reality is a contract for a sale with payment by installments,* it has been expressly provided that the tax herein levied applies to such transactions." (Italics supplied.)

It should also be noted that when considering the Revenue Act of 1921, the House proposed that in the case of the manufacturer who sold his product both at wholesale and at retail the excise tax should be computed upon the amounts actually received in either case. This proposal was rejected. Senate Report 275, 67th Congress, 1st Session, found in 1939-1 C. B. (Part 2) sheds considerable light on the attitude which Congress then entertained concerning the question of whether manufacturers should be

handicapped from a competitive point of view as between each other by the manner in which the excise tax was computed, and was followed by the Congress. That Report states, at page 201 of 1939-1 C. B. (Part 2):

> "MANUFACTURERS DOING A WHOLESALE AND RETAIL BUSINESS.
>
> "Under existing law a manufacturer of any of the articles taxable under Section 900 of the Revenue Act of 1918 doing a wholesale and retail business is permitted to compute the tax upon his retail sales upon the basis of his wholesale selling prices. The House bill eliminated this provision. The effect of the amendment proposed in the House bill would be to make each manufacturer compute the tax in the case of retail sales upon the amount received by the manufacturer from such sale, and would place manufacturers who have to engage in a retail business in order to place their articles upon the market at a great disadvantage when competing with manufacturers who are able to sell entirely at wholesale. Your committee recommends the retention of the present method of computing the tax in the case of retail sales."

The Revenue Act of 1926 made no material change in the language which is here under consideration and the Revenue Act of 1928 repealed all manufacturer's excise tax.

The Court in *Peoples Outfitting Co. v. U. S.*, 58 F. (2d) 847 (Ct. Cls. 1932) in considering the addition of the words "or leased" by the 1924 Revenue Act to the section relating to the excise tax on the sale of jewelry, said (page 851):

> "The same provision under which the tax is now imposed was contained in the 1918 and 1921 Revenue

> Acts. The 1924 Revenue Act made the tax apply also to cases where the same articles were leased, but *we think the intention of Congress in adding the words 'or leased' was to prevent any doubt or conflict where, under contracts of this nature, although fully completed, a claim was set up that the transaction was in fact merely a lease, and therefore not subject to the tax.*" (Italics supplied.)

The manufacturer's sales tax was restored in 1932. Congress then provided in Section 618 of the 1932 Act (later Section 3440, I. R. C., Appendix, *infra*) that "the lease of an article * * * shall be considered a taxable sale of such article." By this language Congress cannot be said to have spoked in either ordinary or precise legal language. That is, a sale is not a lease and a lease is not a sale in accepted legal terminology. Accordingly, it seems only reasonable to conclude that Congress was groping for language which would prevent entire avoidance of the tax and was not attempting by that language to state a different standard of computing the tax. The understanding of the members of Congress at that time is best illustrated by the following quotation from Senate Report 665, 72nd Congress, 1st Session, found in 1939-1 C. B. (Part 2) at page 528:

> "Sec. 616 of the House Bill, retained as Sec. 605 (actually 618) provides that the lease of an article shall be considered the sale of an article, so that the tax cannot be evaded by a lease contract which does not involve passage of title."

The understanding and intention of Congress to adopt an integrated excise tax measure is further illustrated by the fact that in Section 622 of the 1932 Act (later Sec. 3444, I. R. C., Appendix, *infra*) provision was made for

tax on the "use" by a manufacturer of his product, which tax was to be computed on the fair wholesale market value of the product so used.

When Congress, in Section 619 of the 1932 Act (later Sec. 3441, (c), I. R. C., Appendix, *infra*) used the word "lease" in a series of things enumerated, the others being "conditional sales" and "installment sales," it seems quite evident, under the familiar rule of *ejusdem generis,* that the word "lease" was used in the same sense as the context, and that although the transaction was called a lease what was actually intended was a lease which amounted to a sale. This interpretation is aptly illustrated in the *Peoples Outfitting* case, *supra,* and in the quotation from Senate Report 665, *supra.*

Further, construction of the statutes under consideration, should be approached in the light of the doctrine stated by the Supreme Court in the case of *Gould v. Gould,* 245 U. S. 151, 62 L. Ed. 211 (1917):

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the Government, and in favor of the citizen."

In *Bankers Trust Co. v. Bowers,* 295 Fed. 89 (C. C. A. 2d 1923) the Court refused to construe a statute so as to require the income of a decedent and that of his estate to be placed on an annual basis, when another construction of the statutes was possible, saying:

> "Inequity would flow in following the formula proposed for taxation under Sec. 226(a), if applied to a decedent and his estate, particularly if the practice

> was indulged in of using the month and a fraction of a month in calculating the income. Where a construction of a statute will occasion great inconvenience or injustice, that view is to be vetoed if another and more reasonable interpretation is present in the statute."

The situation presented then is one in which the Court is called upon to construe a statute, or a series of related sections of a single Revenue Act, in such a way, within the language used, as will protect the revenue designed to be raised thereby and yet comply with the intention of Congress and the mandates contained in the two decisions last referred to.

If appellants had simply manufactured and sold their product to others for use in a display service business, the revenue to the Government would have been substantially the same as if appellants' contentions herein are adopted. That is, the revenue would have been 10% of the wholesale sales price in the first instance and 10% of the fair wholesale market price of the articles used by appellants, both of which are obviously equal.

To construe the statute otherwise would be to occasion "great injustice" to the taxpayers and in a manner which would closely parallel the situation considered in Senate Report 275, 67th Congress, 1st Session, *supra,* wherein a proposed change in the law was rejected on the ground that to effect the change:

> "* * * would place manufacturers who have to engage in retail business in order to place their articles upon the market at a great disadvantage when competing with manufacturers who are able to sell entirely at wholesale. * * *"

The injustice to appellants who used their product in the operation of a business as a means of producing revenue, as compared with a competitor who purchased appellants' product and thereafter engaged in the same business is easily illustrated. If it be assumed that appellants produced two units and sold one for 37.945¢ and used the other in their business, in competition with the purchaser of the first unit, the excise taxes on the two units, while imposed on the same articles by the same statute, would be computed in vastly different ways. That is, if it be further assumed that the unit retained and used by appellants produced a gross revenue of 60¢ in the first year it was used by them, the Government would demand a tax of 6¢, whereas in the case of the unit sold if it produced the same revenue, a tax of only 3.8¢ would be paid, the tax in the first case being computed on gross revenue and the tax in the second case on the fair wholesale sales price. The gross injustice produced by this method of computing the tax is even more clearly brought out if the second year of competition with the purchaser be considered. In that year it is assumed that each unit again produces 60¢ of revenue to the owner. In the case of the competitor no further tax is collected, but in the case of appellants the Government would demand another 6¢ tax. That is to say, identical units taxed under identical statutes would, in the case of the unit sold to the competitor produce a total revenue to the government of 3.8¢, whereas in the case of the unit used by the manufacturer a revenue of 12¢ would be produced in the first two years and

6¢ per year thereafter during its lifetime. Not only does such an interpretation produce a wide disparity in the application of the taxing act to identical items, but it places appellants "at a great disadvantage when competing" with persons who purchase their product, to paraphrase the language of Senate Report 275, 67th Congress, 1st Session, *supra*.

Applying the rules of the *Gould* and *Bankers Trust Co.* cases, *supra,* as well as common sense, the statute should be construed strongly against the Government and in favor of the taxpayer, and since the construction adopted by the Government would occasion great injustice and a more reasonable interpretation is present in the statute, it seems only logical and equitable to conclude that by using the language that "the lease of an article * * * shall constitute a taxable sale of the article" Congress must be held to have intended to prevent the evasion of the tax "by a lease contract which does not involve passage of title" (S. Rep. 665, *supra*) and not to have intended thereby to increase the revenue or to provide a wide disparity in the tax collected and cause great injustice as between taxpayers contingent only upon the label applied to the transaction.

The interpretation urged herein means that Congress intended the tax to be addressed to a lease which was similar to a sale and to base the tax on the sale price or fair market value of the taxable article and to prevent its entire evasion by a subterfuge. To interpret the statute in the manner here suggested by appellants would not

only protect the revenue designed to be raised thereby, by providing a uniform basis for computing the tax, but would also comply with the mandate of the *Gould* and *Bankers Trust Co.* cases, *supra.*

In addition, a contrary holding has the effect of determining that it was the intention of Congress in the case the transaction took the form of a lease, to impose a tax on revenue only—in substance an income tax—notwithstanding the tax was stated by Congress to be a manufacturer's excise tax. Since an independent income tax statute existed during the time in question, it seems wholly unlikely that by the statute under consideration Congress sought to impose a tax on revenue or income and was undoubtedly directing its taxing power to another sphere, to-wit: the manufacturer's wholesale sales price of an article. This would provide the basis for computing the tax, whether the article was sold at wholesale or retail, leased in such fashion as to constitute for all practical purposes a sale, or used by the manufacturer. This view is sustained by *Indian Motorcycle Company v. United States,* 283 U. S. 570, 75 L. Ed. 1277 (1931), wherein the Supreme Court was construing Section 600 of the Revenue Act of 1924. The Court says (p. 1280):

> "The section provides that there 'shall be levied, assessed, collected and paid upon the following articles sold or leased by the manufacturer, producer, or importer, a tax equivalent to the following percentage of the price for which so sold or leased.'
>
> * * * * * * * *

"Both parties rightly regard the tax as an excise, and not a direct tax on the articles named. But they differ as to the transaction or act on which it is laid. Counsel for the plaintiff insist it is laid on the sale. Counsel for the government regard it is laid on manufacture, production or importation, or, in the alternative, on any one of these *and* the sale. *We think it is laid on the sale, and on that alone. It is levied as of the time of sale and is measured according to the price obtained by the sale.*" (Italics supplied.)

To summarize: Congress defined a taxable sale as including a disposition by a lease contract which closely resembled a sale, *i. e.* a so-called "lease" which provides that title shall pass on payment of the "rent" reserved. Such agreements are sometimes construed as true leases and at others as conditional sales (see 24 R. C. L., Sales, Sec. 747). In the interest of the uniform application of Federal tax laws, and, to avoid distinctions between jurisdictions, it was only reasonable to include this type of "lease" agreement when defining a taxable sale. Hence, Section 3440, Internal Revenue Code, is properly construed as meaning that the same excise tax will accrue whether the article is sold or whether it is "leased" by a "lease" which provides that title shall pass only when the "rent" reserved has been paid, and that this result shall follow whether the instrument be construed as a true lease or as a conditional sale. Since title would never pass under the so-called "Rental Agreement", it was not such a "lease" as would be within the purview of section 3440, Internal Revenue Code.

## III.

## The District Court Erred When It Failed to Construe Section 3441(b), Internal Revenue Code, as Prescribing the Manner in Which the Tax Should Be Computed, in the Case of Taxable Sales Other Than Taxable Sales at Wholesale, and It Further Erred When It Failed to Construe Section 3441(c), Internal Revenue Code, as Prescribing the Time of Payment of the Tax, in the Limited Instances Therein Enumerated.

Section 3406, Internal Revenue Code [Appendix, *infra*], states that an excise tax is thereby imposed "on the price for which (articles are) sold." (Parthensis added.) Section 3440, Internal Revenue Code [Appendix, *infra*], defines the lease of a taxable article, by the manufacturer, as a "taxable sale of such article." If, for the sake of argument only, it be conceded that appellants "leased" their product within the meaning of Section 3440, it would then follow that they had thereby consummated a "taxable sale" of such articles and had become liable, under Section 3406 for tax based "on the price for which sold." Congress, in Section 3441, Internal Revenue Code [Appendix, *infra*], has defined "Sales Price." Subsection (a) of Section 3441 relates to taxable articles sold at wholesale, and since it is not understood that the Government is contending that the appellants "leased" their product at wholesale, that subsection has no application to this Action. Accordingly, the subsection which would determine "the price for which (appellants) sold" (parenthesis added) their products would be subsection (b) of Section 3441, Internal Revenue Code. That subsection reads as follows:

"(b) If an article is—

(1) sold at retail;

(2) sold on consignment; or

(3) sold (otherwise than through an arm's length transaction) at less than the fair market price;

the tax under this chapter *shall* (if based upon the price for which the article is sold) be *computed* on the fair price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner." (Italics supplied.)

Section 3441(c), Internal Revenue Code, reads as follows:

"(c)(1) In the case of (A) a lease, (B) a contract for the sale of an article wherein it is provided that the price shall be paid by installments and title to the article sold does not pass until a future date notwithstanding partial payment by installments, (C) a conditional sale, or (D) a chattel mortgage arrangement wherein it is provided that the sales price shall be paid in installments, *there shall be paid* upon each payment with respect to the article that portion of the total tax which is proportionate to the portion of the total amount to be paid represented by such payment." (Italics supplies.)

The italicized portion of the respective sections show that one states the manner in which the tax "shall * * * be *computed*" and the other states the manner in which the tax "shall be *paid*" in the four cases therein enumerated. It is the purpose of this argument to demonstrate that Congress in the first instance used the word "computed" to mean exactly that, and in the second instance used the word "paid" to mean exactly that. The word "paid" was not employed to mean "computed."

No counterpart of Section 3441(c), Internal Revenue Code, is found in any revenue act prior to 1932. The

problem of when the tax was to be paid in case an article was disposed of on installment payments was dealt with in Regulations 48 (August 1924) which provided, with reference to a conditional sale and to a "lease", as follows:

> "Art 4. *When Tax Attaches:*
>
> * * * * * * * *
>
> "In the case of a conditional sale, where the title is reserved until payment of the purchase price in full, the tax attaches (a) upon such payment, or (b) when title passes if before completion of the payments, or (c) when, before completion of the payments, the dealer disposes of the sale by charging off by any method of accounting he may adopt the unpaid portion of the contract price, or (d) when the vendor discounts the notes of the purchaser for cash or otherwise, or (e) when the vendor transfers his title in the article sold to another.
>
> "In the case of a lease, *which includes a so-called conditional sale agreement purporting to be a lease,* the tax attaches upon the total amount payable under the instrument upon the execution thereof and delivery of the article to the so-called lessee or to a carrier therefor." (Italics supplied.)

It is obvious from the Regulation that the tax "attaches" under five different conditions in the case of a conditional sale, whereas in the case of a lease, it attached at the time of execution and delivery only. In other words, different times for the *payment* of the tax were prescribed in the cases of conditional sales and leases, by the prior Regulation.

Three cases illustrative of the difficulties under the prior law as defined by the last quoted Regulation—both as to the Government and as to the taxpayer—were considered by the Courts.

In the case of *Lippmans, Inc. v. Heiner,* 41 F. (2d) 556 (D. C. Pa. 1930), the Court held that the tax attached when the property was leased (without discussing the meaning of the word "leased"). In *Carter v. Slavick Jewelry Co.,* 26 F. (2d) 571 (C. C. A. 9th, 1928), conditional sales contracts aggregating some $72,000.00 were entered into, whereas only some $49,000.00 was collected thereon. It was held that the tax attached when the contract was entered into, and accordingly, on the higher figure. The Court said,

> "To conclude, it is our view that Congress intended no distinction between an absolute sale and a conditional sale, and that in either case the transaction is assessable when it is entered into."

The Ninth Circuit, in the *Carter* case, *supra,* held that the quoted portion of Regulations 48, so far as it related to postponing the time for payment of the tax, in the case of a conditional sale, was beyond the authority of the Commissioner, and that the tax accrued at the time of execution and delivery in both the case of a conditional sale and a lease. (One dissent.)

*Peoples Outfitting Co. v. U. S.,* 58 F. (2d) 847 (Ct. Cls. 1932), was a case in which an instrument was designated a "lease" and provided for the payment of "rent to lessors" covering jewelry delivered to "lessee" and contained a provision that "lessors" agreed that if "lessee" fulfilled the agreement "lessors" would convey a free and clear title to the property covered. The Collector imposed an excise tax on the ground that the jewelry had been "leased" and that the tax was due when the instrument was signed. Plaintiff contended that the instrument was a conditional sales contract and that the tax was not due until the final payment had been made. It was undisputed

that the final payment was not made until after the repeal of the tax. The Court held that the instrument was in fact a conditional sales contract and, hence, no tax was due, under the provisions of Regulations 48. The Court expressly declined to hold the Regulations invalid as had been done in the *Carter* case, *supra,* although that case was not cited.

The last cited cases clearly point up the inconsistencies and the difficulties which beset both the administrators of the law and the taxpayers with reference to when the tax became due in the case of a so-called "lease" and in the case of a conditional sales contract. With the problems raised by these cases in hand, Congress enacted the precursor of Section 3440 in Section 618 and Section 3441(c) in Section 619(c) of the Revenue Act of 1932, which latter was the same as Section 3441(c) except for subsection (D), *supra.*

The General Counsel of the Bureau of Internal Revenue was early called upon to determine whether a lease fell within the provisions of the sections of the Revenue Act of 1932 last mentioned, and did so in General Counsel's memorandum 11,410, reported at length in Cumulative Bulletin XII-1 at pages 382-384. The General Counsel stated the facts, in part, as follows:

> "Under these contracts the rubber companies, as manufacturers, agree to furnish tires and tubes to operators of busses at a specified rate per mile. The manufacturer also agrees to service the tires and retains title thereto. * * * It is the opinion of this office that the tires and tubes covered by the contracts are leased within the intent of the Revenue Act and are taxable. The operator of the busses *agrees* upon termination of the contract, unless a new contract is entered into, *to purchase the tires* on the basis of the

manufacturer's price list, less the amount already paid under the mileage contract. In the case of damage by accident, abuse, or fire the cost of repair is to be borne by the bus company. In the case of destruction by accident, abuse, or fire the bus company is to be charged at the manufacturer's list price, less mileage paid.

"Section 602 of Title IV of the Revenue Act of 1932 imposes a tax on tires and inner tubes sold by the manufacturer, producer, or importer. Section 618 of the Act provides that:

" 'For the purposes of this title, the lease of an article shall be considered the sale of such article.'

"The questions on which an opinion is requested are as follows:

"Question 1. Should these contracts be considered sales contracts or leases?

Question 2. *How should the tax be computed?* * * *" (Itailcs supplied.)

Following these questions are two more, not relevant to this case, after which the General Counsel reviews the background and legal history of leases generally, and then continues:

"The bailments accomplished by the contracts in question are within the purpose of the statute. *The tax is primarily on sales. Leases were also made taxable because of their similarity to sales.* On page 41 of Senate Report No. 398, relative to the Revenue Act of 1924, it is said:

" 'Section 704(a): Since dealers frequently dispose of goods under a form of contract terms a 'lease', which in reality is a contract for a sale with payment by installments, it has been expressly provided that the tax herein levied applies to such transactions.'

"Section 618 of the Revenue Act of 1932 provides that for the purposes of Title IV the lease of an article shall be considered to be the sale of such article. On page 44 of Senate Report No. 665, relating to that measure it is stated that the foregoing section was retained in the law so that the tax could not be evaded by a lease contract which does not involve passage of title.

"The transactions in the instant case may also be viewed as contracts for the sale of tires with payment by installments measured by the mileage covered. By the contracts in question the parties get practically the same results that sales would produce. The bus company gets the use of the equipment and the manufacturer receives a money compensation approximating, it may be assumed, the sale price of the equipment.

"*  *  *  *  *  *  *  *"

(Italics supplied.)

After thus so pointedly demonstrating that leases are taxable only if sufficiently similar to sales, the memorandum concludes:

"It is the opinion of this office that tires and tubes covered by the contracts are leased within the intent of the Revenue Act and are taxable. This answers the first question. The answers to the second and fourth questions are indicated by S. T. 496 (C. B. XI-2, 455). It is stated therein:

" 'The tax on tires and tubes supplied under a mileage contract *is incurred* at the time when such tires and tubes are delivered by the tire manufacturer to his customer and *should be computed on the full weight of such articles.*'

"*  *  *  *  *  *  *  *"

(Italics supplied.)

There can be no question from the foregoing that the General Counsel of the Bureau of Internal Revenue, writing at the very time of its enactment, entertained serious doubt that leases of *every* type were intended to be included in Sections 618 and 619(c)(1) of the 1932 Act (from which Sections 3440 and 3441(c)(1) are derived), since he has confined his opinion to "leases" which were made taxable "because of their similarity to sales."

Of much more important in assistanting the Court to decide this case, is the fact that the General Counsel, whatever else may be said, did *not* decide that Section 619(c)(1), now Section 3441(c)(1) I. R. C., required a tax which is based upon or measured by the total rental payments received by plaintiffs. He reviewed and confirmed a previous decision by his own office that the measure of the tax was that prescribed by Section 602, of the Revenue Act of 1932. Since he was confronted with and actually decided that the forerunner of Section 3441(c)(1) I. R. C. should be applied in determining whether a taxable transaction had occurred (*i. e.* a "leasing" similar to a "sale") and then determined that a *different section* prescribed *the measure* of the tax, there can be no escape from the conclusion that the General Counsel's ruling was that Section 3441(c)(1) does not prescribe a measure of the tax and the tax in the instant case must be *computed* as prescribed by some other section.

From what has been said it is apparent that, if appellants "leased" their product, and thereby entered into a transaction which constituted a "taxable sale" (I. R. C. 3440) they did so at either wholesale or retail and, in either case, became subject to the manufacturers sales tax based on the fair wholesale price of the articles so sold or leased. The amount of the tax remains the same what-

ever is done, but, if the articles were "leased", then the tax is payable as prescribed by Section 3441(c), Internal Revenue Code, whereas if appellants "used" the article the whole of the tax became due on the first of the month succeeding the month in which the "use" occurred.

The arguments herein presented not merely harmonize the manner in which the tax is to be *computed*—and to agree that the *form* of the transaction determines the quantum of the tax, reflects on the understanding of Congress—but, the revenue is protected by making the tax become due as payments are in fact collected and the inadequacies of prior law are thereby obviated.

If the article is sold at wholesale the tax is computed on the price for which sold. Internal Revenue Code, Section 3441(a). If the article is sold at retail the tax is computed on the fair wholesale price. Internal Revenue Code, Section 3441(b). If an article is used by the manufacturer thereof the tax is computed on the fair wholesale price. Internal Revenue Code, Section 3444. In all cases the tax is due and payable on the first of the month succeeding the month in which the taxable transaction occurred, Internal Revenue Code, Section 3448 [Appendix, *infra*], the only exceptions to this rule being a lease, an installment sale, a conditional sale and a chattel mortgage arrangement, in which four cases only, the tax is computed as directed by one of the previous Sections, but the taxpayer is afforded the privilege, under Section 3441(c), of paying the tax as the sales price is collected.

To illustrate: A manufacturer's fair wholesale price on a certain taxable article is $1,000.00; his retail price $1,500.00. If the tax rate is 5% and he sells at wholesale for cash, the tax is $50.00. Likewise, if he sells at retail, there is no change in the tax rate, and the tax is still

$50.00. If, on the other hand, the manufacturer uses the article in a business in which he is engaged, the tax is computed on the $1,000.00 wholesale price and remains $50.00. In each case the tax is due, in full, on the first of the next month. If, however, the manufacturer sells this article using a conditional sales contract (which is classified the same as a "lease" under Section 3441(c)), and, whether such sale is at wholesale or retail, the tax would be due and payable as follows:

| | | Amount of Tax Due |
|---|---|---|
| Wholesale price | $1,000.00 | |
| Down payment | 100.00 | $ 5.00 |
| Balance | $ 900.00 | |
| Add interest, carrying charges, etc. | 100.00 | |
| Total installment payments due | $1,000.00 | |
| First month | 100.00 | 4.50 |
| | $ 900.00 | |
| Second month | 100.00 | 4.50 |
| | $ 800.00 | |
| Third through tenth month | 800.00 | 36.00 |
| Total tax due and payable | | $50.00 |
| Total money collected | $1,100.00 | |

| | | Amount of Tax Due |
|---|---|---|
| Retail price | $1,500.00 | |
| Down payment | 100.00 | $ 3.33 |
| Balance | $1,400.00 | |
| Add interest, carrying charges, etc. | 150.00 | |
| Total installment payments due | $1,550.00 | |
| First month | 100.00 | 3.11 |
| | $1,450.00 | |
| Second month | 100.00 | 3.11 |
| | $1,350.00 | |
| Third through fifteenth month | 1,350.00 | 40.45 |
| Total tax due and payable | | $50.00 |
| Total money collected | $1,650.00 | |

The monthly installments of tax due in the case of the sale at retail have been computed by determining what portion of the payment is proportionate to the total to be paid on account of the fair wholesale price (*i. e.* $1,000.00 minus 10/15th of the down payment or $66.67 = $933.33 ÷ by the number of payments (15) = $62.22 per month X the rate of tax (5%) = $3.11 tax due per month).

The illustration points up the fact that in all cases of the disposition of the same article—whether by wholesale, retail, use, lease, installment sale, conditional sale or chattel mortgage—a taxable transaction results and that in each case the amount of the tax is exactly the same, the only difference being that Section 3441(c), Internal Reve-

nue Code, permits, as it says, the tax to be paid, in the cases therein enumerated, as the installments are in fact collected. In no case, however, is the tax to be computed on the money collected or gross revenue as was done in appellants' case.

## IV.

## The District Court Erred When It Determined That Appellants Did Not Use Their Product in the Operation of a Business in Which They Were Engaged Within the Meaning of Section 3444 of the Internal Revenue Code.

Appellants concede that they manufacture a taxable article and that they "used" various numbers of that article —to be exact 81,429 of them—within the meaning of Section 3444 of the Internal Revenue Code [R. 54], and that they are accordingly liable to an excise tax based upon the fair wholesale market value of the articles so used, but not upon gross revenue from their whole display service business.

A striking analogy occurs between Section 3444 of the Internal Revenue Code [Appendix, *infra*] and Section 23(k) of the Revenue Act of 1932. The latter section concerns deductions from income and provides, in part, that such deductions shall include:

> "* * * a reasonable allowance for the wear and tear of property *used in the trade or business,* including a reasonable allowance for obsolescence. * * *" (Italics supplied.)

Similar language contained in Section 23(k) of the 1928 Revenue Act was considered by the Court in *Kittredge v. Commissioner,* 88 F. (2d) 632 (C. C. A. 2nd,

1937). The facts in that case were that plaintiff acquired a winery in 1919, that it was operated only slightly until 1922, and that from 1922 to 1931 the winery stood idle, and in the latter year was abandoned by plaintiff who claimed the entire cost as a loss. The Court held that the phrase quoted from Section 23(k) should be read as equivalent to "*devoted* to the trade or business" (italics supplied), and hence that depreciation was allowable during the period when the winery remained idle. Accordingly Kittredge was required to deduct the depreciation from his basis in determining the amount of his loss, because during the period 1922 to 1931 the idle winery was considered by the Court as "devoted to trade or business" and hence "used in trade or business."

A similar case is *Yellow Cab Co. etc. v. Commissioner*, 24 F. Supp. 993, wherein the cab company purchased taxicabs in 1931 and placed them in storage from July, 1931, to November 30, 1935, because of poor business conditions, at which latter date the taxicabs were abandoned. The Court held that the corporation had intended to use the taxicabs during the time they were stored if business had improved and, accordingly, that the taxicabs were being "used in the trade or business" during the period they were in storage and that a deduction for depreciation was allowable during that time. The basis of the corporation was therefore reduced by the amount of the depreciation allowable and the amount of the loss accordingly reduced.

In construcing Section 23(l) of the Revenue Act of 1938, the Board of Tax Appeals (now The Tax Court of the United States) said in *John D. Frackler v. Commissioner*, 45 B. T. A. 708 at page 714:

> "The rule deducible from the above decisions is that, *where the owner of depreciable property devotes*

> *it to rental purposes and exclusively to the production of taxable income, the property is used by him in a trade or business* and depreciation is allowable thereon." (Italics supplied.)

The decision was affirmed in 133 F. (2d) 509 (C. C. A. 7th, 1943).

The Court below found [R. 24] that "* * * plaintiffs have been engaged in the business of manufacturing, selling and leasing certain rubber articles * * *." The record discloses that appellants operated a display service business, the main purpose of which was to supply meat markets and butchershops with a decorative service. Appellants' representatives were trained meat display experts [R. 62, 63] who not only relieved the butcher of the chore of changing fresh greens but also gave practical instruction in the display and cutting of meats [R. 48]. Appellants conducted a business, in connection with which, and as a part of which, they used a taxable article manufactured by them. To paraphrase the language of the *Frackler* case, *supra:* Appellants, as owners of rubber leaf decorations, devoted those decorations to rental purposes and exclusively to the production of taxable income, and the rubber leaf decorations were used by them in a trade or business. It is true that depreciation is not an issue in this case, but there is squarely presented the issue of whether appellants "used" their rubber leaf decorations within the meaning of Section 3444, Internal Revenue Code. The definition contained in the *Frackler* case, *supra*, states the meaning of the word "use" as employed by Congress in one section of the Internal Revenue Code and no reason is apparent why a different definition should apply to the same word merely because employed in a different section of the same code. The conclusion is in-

escapable that appellants "used their product in the operation of a business in which they were engaged" and, accordingly, as prescribed by Section 3444, Internal Revenue Code, the tax "shall be *computed*" upon the fair wholesale price of the articles so used, and the whole amount of such tax was due and payable on the first day of the month succeeding the month in which the use occurred.

## Conclusion.

It is submitted that the manufacturer's excise tax due from appellants was erroneously computed based upon the gross revenue derived from the operation of appellants' display service business and that the judgment below, which affirmed that method of computation, was in error and should be reversed.

Respectfully submitted,

JOHN T. RILEY and
RICHARD K. YEAMANS,
*Attorneys for Appellants.*

## APPENDIX.

### Statutes and Regulations Involved.

Section 3406, Internal Revenue Code: "EXCISE TAXES IMPOSED BY THE REVENUE ACT OF 1941:

"(a) Imposition.—There shall be imposed on the following articles, sold by the manufacturer, producer, or importer, a tax equivalent to the rate, on the price for which sold, set forth in the following paragraphs (including in each case parts or accessories of such articles sold on or in connection therewith, or with the sale thereof):

* * * * * * * *

"(7) Rubber articles.—Articles of which rubber is the component material of chief weight, 10 per centum. The tax imposed under this paragraph shall not be applicable to footwear, articles designed especially for hospital or surgical use, or articles taxable under any other provision of this Chapter."

Section 3440, Internal Revenue Code: "DEFINITION of SALE. (As amended by Section 553, 1941 Act):

"For the purpose of this Chapter the lease of an article (including any renewal or any extension of a lease or any subsequent lease of such article) by the manufacturer, producer or importer shall be considered a taxable sale of such article."

Section 3441, Internal Revenue Code: "SALE PRICE:

"(a) In determining, for the purposes of this chapter the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment, but there shall be excluded the amount of tax

imposed by this chapter, whether or not stated as a separate charge. A transportation, delivery, insurance, installation, or other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to the satisfaction of the Commissioner, in accordance with the regulations.

"(b) If an article is . . .

(1) sold at retail;

(2) sold on consignment; or

(3) sold (otherwise than through an arm's length transaction) at less than the fair market price; the tax under this chapter shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner.

"(c) (1) In the case of (A) a lease, (B) a contract for the sale of an article wherein it is provided that the price shall be paid by installments and title to the article sold does not pass until a future date notwithstanding partial payment by installments, (C) a conditional sale, or (D) a chattel mortgage arrangement wherein it is provided that the sales price shall be paid in installments, there shall be paid upon each payment with respect to the article that portion of the total tax which is proportionate to the portion of he total amount to be paid represented by such payment. * * *"

Section 3444, Internal Revenue Code: "USE BY MANUFACTURER, PRODUCER, OR IMPORTER (as amended by Sec. 553, 1941 Act):

"(a) If—

"(1) any person manufactures, produces, or imports an article (other than a tire, inner tube, or automobile radio taxable under section 3404) and uses it (otherwise than as material in the manufacture or production of, or as a component part of, another article to be manufactured or produced by him which will be taxable under this chapter or sold free of tax by virtue of section 3442, relating to tax-free sales); or

"(2) any person manufactures, produces, or imports a tire, inner tube, or automobile radio taxable under section 3404, and sells it on or in connection with, or with the sale of, an article taxable under section 3403 (a) or (b), relating to the tax on automobiles, or uses it; he shall be liable for tax under this chapter in the same manner as if such article was sold by him, and the tax (if based on the price for which the article is sold) shall be computed on the price at which such or similar articles are sold, in the ordinary course of trade, by manufacturers, producers, or importers thereof, as determined by the Commissioner."

Section 3448, Internal Revenue Code: "RETURN AND PAYMENT OF MANUFACTURERS' TAXES.

"(a) Every person liable for any tax imposed by this chapter other than taxes on importation shall make monthly returns under oath in duplicate and pay the taxes imposed by this chapter to the collector for the district in which is located his principal place of business or, if he has no principal place of business

in the United States, then to the collector at Baltimore, Maryland. Such returns shall contain such information and be made at such times and in such manner as the Commissioner, with the approval of the Secretary, may by regulations prescribe.

(b) The tax shall, without assessment by the Commissioner or notice from the collector, be due and payable to the collector at the time so fixed for filing the return. * * *"

Section 316.5, Treasury Regulations 46 (1940): "WHEN TAX ATTACHES:

* * * * * * * *

"In the case of a lease, an installment sale, a conditional sale, or a chattel mortgage arrangement, a proportionate part of the tax attaches to each payment. (See section 316.9.) In case of use by the manufacturer the tax attaches at the time the use begins."

Section 316.7, Treasury Regulations 46 (1940): "TAX ON USE BY MANUFACTURER, PRODUCER, OR IMPORTER:

"If a person manufactures, produces, or imports an article covered by these regulations, except a tire or inner tube, and uses it for any purpose (other than as material in the manufacture or production of, or as a component part of, another article manufactured or produced by him which will be taxable or sold free of tax under the provisions of section 316.21 or 316.22, he shall be liable for tax with respect to the use of such article in the same manner as if it were sold by him.

"If a person manufactures, produces, or imports tires and/or inner tubes, and sells them on or in connection with, or with the sale of, automobiles, taxable tractors, or motorcycles, or if he uses them for any purpose whatever, he shall be liable for tax in such cases as if such tires and inner tubes were sold by him as separate articles. The tax will be computed at the rates prescribed by section 3400. (See sections 316.30 to 316.32, inclusive, and section 316.54.)

"The use by any person, in the operation of a business in which he is engaged, of any taxable article which has been manufactured, produced, or imported by him or his agent, makes such person liable to tax on such use. Except in the case of tires and inner tubes the tax will be computed on the basis of the fair market price of the article. (See section 316.15.) However, the tax on the use of such taxable article will not attach in cases where an individual incidentally manufactures, produces, or imports for his personal use or causes to be manufactured, produced, or imported for his personal use any taxable article."

Section 316.9, Treasury Regulations 46 (1940): "Basis of Tax on Leases, Installment Sales, Conditional Sales and Sales Under Chattel Mortgage Arrangements:

"Special provision is made in the law for computing taxes due in the case of leases of articles and installment and so-called conditional sales. The term 'lease' means a continuous right to the possession or use of a particular article for a period of time. It does not

include the use of an article merely as occasion demands, but the contract must give the lessee the right to possess or use the article, without interruption, for a period of time.

"Where articles are leased by the manufacturer, or sold under an installment-payment contract with title reserved, or under a conditional-sale contract with payments to be made in installments, a proportionate part of the total tax shall be paid upon each payment made with respect to the article. The tax must be returned and paid to the collector during the month following that in which such payment is made.

* * * * * * * *"

Section 316.15, Treasury Regulations 46: "FAIR MARKET PRICE IN CASE OF RETAIL SALES, CONSIGNMENTS, ETC., GENERALLY:

"The law provides a special basis of tax computation where sales are at less than the fair market price and not at arm's length. The fair market price is the price for which articles are sold by manufacturers at the place of distribution or sale in the ordinary course of trade and in the absence of special arrangements. A sale is not at arm's length when made pursuant to special arrangements between a manufacturer and a purchaser (as in the case of intercompany transactions). When a sale is not at arm's length and the price is less than the fair market price (as in the case of intercompany transactions at cost or at a fictitious price), the tax is to be computed upon a fair market price to be computed by the Commis-

sioner. No deduction from the fair market price as determined by the Commissioner is permissible.

"Where a manufacturer sells articles at retail, the tax on his retail sales ordinarily will be computed upon a price for which similar articles are sold by him at wholesale. However, in such cases it must be shown that the manufacturer has an established bona fide practice of selling the same articles in substantial quantities at wholesale. If he has no such sales at wholesale, a fair market price will be determined by the Commissioner.

"If a manufacturer sells regularly at wholesale at several varying but bona fide rates of discount, ordinarily his average selling price for the smallest wholesale lots will be the basis of tax with respect to retail sales. All sales at wholesale are subject to tax on the basis of the actual sale price of each article so sold.

"If a manufacturer delivers articles to a dealer on consignment, retaining ownership in them until disposed of by the dealer, the manufacturer must pay a tax on the basis of the fair market price, which will ordinarily be the net price received from the dealer."